

# CRITICAL ACCESS HOSPITALS PAYMENT SYSTEM

*payment***basics**

Medicare beneficiaries can receive care in approximately 1,200 small hospitals called critical access hospitals (CAHs). CAHs are limited to 25 beds and primarily operate in rural areas. Unlike traditional hospitals (which are paid under prospective payment systems), Medicare pays CAHs based on each hospital's costs. Each CAH receives 101 percent of its costs for outpatient, inpatient, laboratory and therapy services, as well as post-acute care in the hospital's swing beds.<sup>1</sup>

In addition to 25 acute beds, CAHs are allowed to have distinct-part skilled nursing facilities, 10-bed psychiatric units, 10-bed rehabilitation units, and home health agencies. However, these departments of the CAH are paid through Medicare's prospective systems and are not eligible for cost-based reimbursement.

## **History of the CAH program**

In 1988, the Montana Hospital Research and Education Foundation designed a demonstration of a type of hospital called a medical assistance facility (MAF) that received cost-based reimbursement from Medicare. MAFs were isolated, limited-service hospitals that could admit patients for no more than a four-day length of stay. In 1989, the Congress authorized the Rural Primary Care Hospital (RPCH) program, a second demonstration program whereby small, rural hospitals would receive cost-based payments from Medicare. In 1997, the Balanced Budget Act of 1997 merged the MAF and RPCH programs into a new category of hospitals called critical access hospitals. CAHs would receive cost-based inpatient and outpatient payments from Medicare.

To qualify for the CAH program, a hospital had to be at least 15 miles by secondary road and 35 miles by primary

road from the nearest hospital or be declared a "necessary provider" by the state. Because states could waive the distance requirement, the CAH program became an option for almost all small rural hospitals, as opposed to being limited to helping isolated hospitals. Approximately 65 percent of CAHs are between 15 and 35 miles from the nearest hospital. However, some are less than 5 road miles from another hospital and others (approximately 20 percent of CAHs) are more than 35 road miles from an alternative source of emergency care.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 eliminates states' ability to declare additional hospitals "necessary providers" starting in January 2006. As a result, CMS will essentially cease to authorize additional CAHs because almost all hospitals that meet the distance and size criteria have already converted to CAH status. Current CAHs will retain their CAH status, even if they do not meet the distance criteria.

## **Defining the care that Medicare buys from CAHs**

Medicare pays for the same services from CAHs as from other acute care hospitals (e.g. inpatient stays, outpatient visits, laboratory tests, and post-acute skilled nursing days). However, CAHs' payments are not based on the type of service provided or the number of services provided. Payments are based on each CAH's costs and the share of those costs that are allocated to Medicare patients.

## **Computing Medicare payments**

Medicare pays CAHs 101 percent of their allowable costs for most services. The cost of treating Medicare patients is estimated

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using cost accounting data from Medicare cost reports. CMS's cost accounting methodology allocates costs among patients based on a combination of factors such as the number of days a patient stays in the hospital and the dollar value of charges the patient incurs for ancillary services.

MedPAC projects Medicare's cost-based payments to CAHs to total roughly \$5 billion in 2006, representing between 3 and 4 percent of all Medicare inpatient and outpatient payments to hospitals.

### **Differences between CAH and SCH Medicare payments**

It is important to distinguish between "cost-based payments" provided to CAHs from "cost-based payments" paid to sole community hospitals (SCHs). SCHs receive the higher of either (a) standard inpatient prospective payment rates or (b) payments based on the hospital's costs in a base year updated to the current year

and adjusted for changes in their case mix. The SCH payment methodology differs in two significant ways from CAH cost-based payments. First, SCHs only receive cost-based payments for inpatient care; CAHs receive cost-based payments for inpatient, outpatient, lab, therapy, and post-acute services in swing beds. Second, SCHs payments are based on historical costs trended forward. Therefore, if a SCH increases its expenditures per patient, its payments will not be affected. In contrast, if a CAH increases its expenditures per patient, Medicare payments increase accordingly. To qualify for the SCH program, a hospital must be located at least 35 miles from the nearest like hospital (excluding CAHs), or meet other federal criteria for being deemed a community's sole source of care. Most rural hospitals are either CAHs or SCHs. ■

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<sup>1</sup> Most CAH beds are "swing beds", which can be used for acute or post-acute care. In some states, these beds can also be used for long-term care of Medicaid patients.